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C O N F I D E N T I A L CARACAS 001446

SIPDIS

NSC FOR TSHANNON AND CBARTON
ENERGY FOR DPUMPHREY AND ALOCKWOOD

E.O. 12958: DECL: 04/27/2014
TAGS: ENRG PREL EPET VE
SUBJECT: GOV DENIES OIL WILL GO TO CHINA

REF: CARACAS 1350

Classified By: Amb. Charles Shapiro; for reasons 1.4 (b) and (d)

SUMMARY

¶1. (C) The GOV said once again on April 26 that Venezuela would continue to be a reliable oil supplier to the United States. The statement was made in response to a story in Miami's "El Nuevo Herald" picked up by all leading Caracas dailies the morning of April 26, which alleges that Chavez has a secret plan to sell Venezuelan oil to China instead of to the U.S. Industry experts quoted in the press on April 27 detailed the reasons (from refinery and shipping constraints to the size of the price discount Venezuela would probably have to offer to China) why such a deal would be a poor one for Venezuela. One expert commented to econoff that, while such a deal might be possible, Chinese interest in it would be another question, particularly given that it would inevitably strain China's ties to the U.S. In sum, Chavez would have to be willing to impose massive losses on Venezuela on purely political grounds. This cannot be discounted entirely since Chavez governs by political instinct rather than economic rationality, but we believe Chavez is likely to consider cutting off oil exports to the U.S. if bilateral relations worsen signficantly, or he sees such a move as important to his survival in power. End Summary.

OIL TO CHINA

¶2. (U) On April 26, Caracas dailies headlined a story picked up from Miami's "El Nuevo Herald" alleging that Chavez has a secret plan to sell one million barrels per day of crude to

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China. Quoting former National Security Senior Deputy Constantine Menges, the story states that Chavez "is not only preparing for a radical cut-off of supplies to the U.S., but also to use oil as a political weapon in order to impede the reelection of President George W. Bush."

¶3. (U) Minister of Communications and Information Jesse Chacon later denounced the story, stating categorically (as was reiterated in a subsequent press announcement released by the Vice President's office) that the information was totally false. Chacon characterized the "El Nuevo Herald" story as a "dirty war" story, generated by a columist paid by the Venezuelan opposition. Chacon underlined that the only time oil exports to the U.S. had been suspended during the Chavez presidency had occured during the opposition-supported strike in December 2002. Chacon continued, "We hope and are sure that this will not occur again, that is, that the U.S. has a guarantee that the supply will continue, commercial relations will continue to grow, gas concessions have been granted, a policy has been designed to diversify our crude and products in the U.S...."

BUT, HOPEFULLY, WISER HEADS WILL PREVAIL

¶4. (U) On April 27, Caracas dailies reported Chacon's denial as well as comments from various industry experts attesting to the pain such an action would inflict on Venezuela's own bank balances. The analysts quoted in the press cited the difficulties of diverting Venezuela's heavy, sour crudes from the U.S. deep conversion refineries, the problems and costs of shipping Venezuelan oil to China vice the U.S., and the deep discounts Venezuela would probably have to offer China in order to sign such a contract. Ciro Izarra, the former Manager of PDVSA's Commercial Division, speculated to the press that that such a contract would represent a $2 million daily loss for Venezuela.

¶5. (C) Econoff discussed the possibility of China sales with an industry source who commented that it is conceivable that China could buy Venezuelan crude. After all, he noted, China

already buys orimulsion from Venezuela. But, he noted, China has never run a lot of Venezuelan crude through its refineries. He suggested that the Chinese would want to purchase a number of test shipments in order to estimate the economics of a deal. Finally, he added, while such a deal might be possible, Chinese interest in it would be another question, particularly given that it would inevitably strain China's ties to the U.S. Turning to the economics of such a deal for PDVSA, Venezuela's state-owned oil company, he noted that PDVSA currently makes its royalty payments to the GOV based on the actual prices it receives from oil sales. The Ministry of Energy and Mines is currently pushing, he said, to shift to a royalty based on a price formula based on U.S. West Gulf prices -- assumed to be the best that PDVSA could receive. Any deal with China would probably inflict huge losses on PDVSA.

COMMENT

¶6. (C) The Chavez administration has once again denied any intent to divert its oil sales from the U.S. market (although President Chavez himself has stated that it might use such an option). On economic grounds, such a decision would be monumentally foolish. Chavez would have to be willing to impose losses on Venezuela and on PDVSA on purely political grounds. This cannot be discounted entirely as Chavez himself is disposed to stir the pot by his own comments on the possibility of cutting off oil to the U.S. (reftel). Doubtless PDVSA has been told to analyze all alternatives to the U.S. as a commercial partner, but we believe that Chavez is likely seriously to consider a cut-off only if our bilateral relations have deteriorated considerably more than they have already and he sees such a move as important to his survival in power.
SHAPIRO

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